Close Brothers Asset Management

Close Select Fixed Income Fund

Monthly fund manager update

JANUARY 2021

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FUND PERFORMANCE

The Close Select Fixed Income Fund outperformed the Investment Association Sterling Strategic Bond Sector (IA) by +0.65% in January 2021, generating a total return of +0.49%.

This positive month, follows the Fund's strong outperformance in the second half of 2020 when it returned +7.3%, while the IA Sterling Strategic bond sector returned +5.6%.

MACRO BACKDROP

Newsflow in January 2021 was dominated by the ongoing COVID-19 vaccine rollout, and how quickly major economies might begin to re-open. As such, forward-looking macro data is balancing the negative short-term impact from ongoing lockdowns and social restrictions, against the 6- to 12-month positive outlook that the vaccine rollout has created. Despite near-term volatility, 2021 GDP growth forecasts in the UK, US and Eurozone are +4.7%, +4.1%, and +4.3%, respectively.

In the UK, January composite PMI data fell to 40.6 (from 50.4 in December), as 'lockdown' announcements indicate major restrictions could remain throughout Q1 2021. Consensus forecasts were upgraded however, with Q4 2020 GDP growth forecast now at -1.4%, and overall 2020 GDP growth upgraded to (a still weak) -10.6% (from -12% in December). Inflation is expected to remain below 2% until 2023; and unemployment is expected to peak at c. 7% in Q2 2021.

In the US, forward-looking data remained strong, with January composite PMI data of 58.0 (the 2nd highest reading in the last 12-months after a strong November print of 58.6). Despite ongoing public health concerns in the US related to COVID-19, consensus forecasts continue to improve, with overall 2020 GDP growth confirmed at -3.5%. The positive growth forecasts have translated into expectations of rising inflation, with inflation expected to reach 2.7% in Q2 2021, and unemployment to continue to improve from the December figure of 6.7%.

In the Eurozone, January composite PMI data weakened to 47.5 (versus 49.1 in December), while consensus GDP growth forecasts for Q4 2020 were simultaneously downgraded to -2.4% as additional lockdown measures were implemented across much of the Eurozone. Inflation is expected to remain below 1.2% until 2023 and unemployment is expected to peak at c. 9% in Q2 2021.

PORTFOLIO ACTIVITY

Portfolio activity in January was focused on significantly de-risking the fund, whilst simultaneously maintaining a "better-than-sector" yield. Our rationale is simple: 1) valuations are rich across virtually all asset classes (which leads us to reduce portfolio risk); and 2) the macroeconomic outlook should remain positive for the next 12-months (which should lead to rising rates).

We executed our de-risking strategy by: increasing overall credit quality; reducing exposure to higher beta bonds; significantly reducing duration; and raising cash to record high levels. Despite this cautious approach, we generated strong positive returns in January, and believe we still offer a better yield than the sector.

Key trades during the month included selling the majority of our Sainsbury's 2021 convertible bond at a yield of -6% (the bond has 6-months to maturity, and strong financial performance has fuelled a rally); as well as reducing exposure in a series of Financials bonds (Virgin Money, Nationwide, Caixa Bank, Raiffeisen Bank, Commerzbank, Phoenix Group and Bupa). These sales were partially offset by adding to a high quality Zurich Insurance 2031 bond ('A' rated with a 3.0% yield).

On the portfolio construction side, cash levels are at 18%, duration is 2.9 years, and yield-to-expected-call is 2.4% (the Yield to Maturity is 3.0%, but we believe the lower figure is a more accurate measure of yield). The average credit rating on the rated portion of the portfolio is BBB+, and the unrated portion of the fund is 10% (in 2020, c. 10% of unrated exposure received an inaugural rating, while c. 10% of unrated bonds matured).

OUTLOOK AND STRATEGY

All fixed income sub-asset classes now appear rich:

- **Sovereign bond yields** remain at (or near) record lows across the US, UK and Eurozone given volatile macro data; Central Bank intervention; and COVID-19 concerns.
- **Sterling Investment Grade** bonds are rich versus all historical timeframes, with sterling 'BBB' credit spreads at 144bps, versus their 5yr average of 185bps; 10yr average of 218bps; and 20yr average of 217bps.
- **Sterling High Yield** spreads are rich versus history, with 'BB' spreads at 306bps versus their 5yr average of 337bps; 10yr average of 386bps and 20yr average of439bps).

In an effort to preserve capital and deliver a high level of monthly income, we continue to seek out the best risk/reward ideas across investment grade, unrated and high yield bond sectors. We maintain our focus on stock selection reinforced by in-depth credit research.

CLOSE SELECT FIXED INCOME FUND PERFORMANCE AS AT 31 JANUARY 2020

	YTD	2020	2019	2018	2017	2016
Close Select Fixed Income Fund	**0.49%**	**4.2%**	**9.4%**	**-2.0%**	**7.4%**	**8.0%**
IA £ Strategic Bond	-0.16%	6.6%	9.3%	-2.5%	5.3%	7.3%

SOURCE:

FE Analytics 03.02.2021; YTD data as at 31.01.2020; all figures are for the X Acc share class; performance is total return, net of fees with dividends reinvested.